MERISTEM

Macroeconomic Update

MPC Monitor | January 2022

MPC Maintains Status Quo

The Monetary Policy Committee held its first meeting of the year on the 24th and 25th of January 2022, where it voted to keep all policy parameters unchanged.

In reaching its decision, the Committee considered the weakening optimism surrounding global economic recovery mainly attributable to the rising inflationary pressures, emergence of new COVID-19 variants, supply chain bottlenecks and the commencement of rate normalization by some monetary policy committees globally. The Committee, however, noted that advanced economies have a stronger capacity to offset the headwinds relative to the emerging and developing economies due mainly to the better access to vaccines and better policy support.

On the domestic front, the Committee considered the continued improvement in general output levels as well as sustained inflationary pressure while noting the impact sustained intervention programmes.

Although the Committee is cognizant of the potential impact of rate hikes by monetary policy authorities in advanced economies on capital flows to emerging markets, it considers the risk of capital flight from Nigeria minimal. Also, the need to continue to support growth (which remains fragile) is an overriding factor.

In our opinion, the decision to hold all parameters constant was widely anticipated and is not expected to have a significant impact on asset prices market conditions.

Committee's Considerations

The committee considered the unrelenting effort made by both the fiscal and monetary authorities in 2021 to mitigate the impact of virus but highlighted that further concerted effort is required to improve output growth momentum and solidify gains achieved so far.

Attributing the uptrend in the inflation rate for December 2021 to the higher demand associated with the festive season, the committee expressed concerns about insecurity especially in food producing regions while acknowledging the progress made in food (particularly rice) production.

The committee highlighted that setting up private refineries across the country is key to reducing government influence on domestic fuel price. It also considered the ongoing fuel subsidy debate, noting that a step wise approach would be needed to ensure the impact of energy cost on individuals, households and businesses is moderate.

The MPC applauded the improvement of foreign capital inflow through diaspora remittance and urged the Bank to further extend the incentive scope to ensure remittance flow in through official sub-channel. Committee members also expressed concern about the country's rising debt profile, stating its potential impact on fiscal sustainability as well as the financial system's performance and growth. It therefore urged the government to seek other revenue sources outside of oil so as to ease the expenditure burden.

Despite the pandemic's impact on individuals and businesses, the committee applauded the apex bank's effort in ensuring the continued downward trend in Non-Performing Loan ratio, signifying improved condition in the banking system. However, the need to closely monitor developments and swiftly respond to emerging challenges is paramount.

Key Decisions

- Retained the MPR at 11.50%
- Retained CRR at 27.50%
- Retained liquidity ratio at 30.00%
- Retained the asymmetric corridor at +100bps/-700bps around the MPR

Anticipated Impacts

The Banking Sector: Lower Funding Cost to Continue to Support Net Interest Margin

The performance of interest income was not spectacular in 2021 due to the downtrend in yields on investment securities for most of the year. Although yields increased at the start of the year, the increase was short-lived.

The Committee's decision to hold the MPR constant is not expected to have any material impact on asset yields in 2022. Moreover, prime lending rate (11.13% - 11.80%) and maximum lending rate (27.10% - 29.05%) hovered around a narrow lower range in 2021 (vs. 11.31% - 15.65% and 28.31% - 30.77% in 2020 respectively), and a similar trend is expected in 2022. As a result, banks will have to look to volume growth and lower funding costs to drive net interest margins.

In terms of other key metrics such as capital adequacy, asset quality and liquidity, the banking sector is generally not in a bad place at the moment. Other factors outside the Committee's decision such as the implementation of BASEL III are more likely to impact these metrics in our opinion.

The Real Sector: Sustaining Growth Trajectory

Feeding off the supportive efforts of both monetary and fiscal authorities, Nigeria's output has maintained a growth trajectory (4.03% in Q3:2021 vs 5.01% in Q2:2021). This is corroborated by the Manufacturing Purchasing

Managers' Index (PMI) for December 2021, which increased to 52.0pts 2021 (vs 50.8pts in November 2021), performing above the 50pts benchmark. The Non-Manufacturing PMI, however, declined marginally to 48.0pts in December 2021 (vs 48.6pts in November), reflective of the decline in services. The Committee's decision to retain rates highlights its commitment to sustain economic growth despite the heightened inflationary pressure (15.63% in December 2021 vs 15.40% in November 2021).

We expect the Committee's decision to hold all policy parameters at current levels alongside its sustained intervention programs, to give more room for sustained economic growth in the real sector.

The Fixed Income Market: Monetary Policy's Role to Remain Muted on the Fixed Income Market

Yields in the fixed income market maintained a downward trend at the end of 2021, but the sentiment in 2022 has however been mixed. Stop rates at the Primary Market Auction (PMA) for Treasury Bills have remained mostly flat at 2.50% and 3.44% on the 91-day and 182-day instruments. However, stop rates on the 364-day instrument have increased by 60bps to 5.50% at the last auction. This is probably an indicative of the government's strong funding need in view of the 2022 budget deficit.

Given the current level of negative real returns (estimated at -10.15% for treasury bills and -4.11% for FGN bonds), and the level of uncertainty with regards to the direction of yields, retaining the benchmark rate is expected to have a muted impact on fixed income instruments over the near to medium term.

The Equities Market: Committee's Decision to have Negligible Impact on Equities Market

The mood in the local bourse has been bullish so far in 2022, with the market closing positive on the first three weeks of the year. Thus, the All-Share Index advanced by 7.55% Ytd. Compared to its peers, the Nigerian equities market (at a PE ratio of 10.18x) is valued at a mid-point: while it is less attractive than its Ghanian (PE ratio: 5.37x) and Egyptian (PE ratio: 8.77x) peers, it provides more value than its Kenyan (PE ratio: 11.33x), South African (PE ratio: 12.16x) and Emerging markets (PE ratio: 13.89x) peers.

We expect the anticipation of strong corporate earnings to have a significant bearing on the equities markets. Thus, the Committee's decision to retain rates is expected to have a muted demand and pricing of local stocks.

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